

Investment Age

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Rally's endurance doubted

By Margaret Price
and Trudy Ring

Yet some strategists raise stocks, lower cash

Heady times have returned to Wall Street, but not all institutional investors believe the good times will last.

On Wall Street, the market's surge has many participants claiming the market is on a roll, with some seeing the Dow Jones Industrial Average attaining 3000 this year. The Dow has risen more than 14%

from its Dec. 30 close of 2168.57; following a dive in U.S. producer prices and drops in interest rates, it hit a post-crash high of 2502.02 May 22 and closed May 24 at 2483.87.

But while some of Wall Street's prominent portfolio strategists scurried to change their recommended asset mix,

more than half of the investment executives interviewed by *Pensions & Investment Age* were far from bullish.

On Wall Street, Merrill Lynch & Co.; Goldman, Sachs & Co.; and Salomon Brothers Inc. have recommended increasing equity allocations by reducing cash.

Their rationale usually cen-

ters on classic economic fundamentals: Interest rates are at or near their peak; inflation appears to be under control; and recession still appears distant so corporate profits remain at least satisfactory.

Salomon Brothers at the end of April changed its "view of the equity market and asset allocation from a 50-50

stocks-to-cash (ratio) to 80-20, stocks-to-cash, for equity portfolios," said Robert S. Salomon Jr., a managing director and head of equity research.

Goldman, Sachs' investment policy committee decided a 35% weighting in cash for all-equity model portfolios was "much too conservative," said Steven Einhorn, committee chairman. Mr. Einhorn

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Photo by Michael A. Marcotte

McDonald's Corp. is opening its ESOP debt offering to non-qualified investors, a move that reflects a broader interpretation of the code governing the tax benefits of the securities.

ESOP debt tax issue surfaces

By Barry B. Burr

Opposing interpretations of tax regulations have surfaced in the first two public offerings of publicly traded debt by leveraged employee stock ownership plans.

In one case, investors will pay the price if the opinion is wrong.

Brunswick Corp., Skokie, Ill., takes a cautious approach, refusing to allow non-qualified investors, including its two investment banks, to buy its publicly offered ESOP debt. But McDonald's Corp., Oak Brook, Ill., in its ESOP debt offering, will allow its investment bank and any other non-qualified investors to buy and hold the securities almost without exception.

As a result, Merrill Lynch Capital Markets and Shearson Lehman Hutton Inc., Brunswick's investment banks, will act only as agents, while Salomon Brothers Inc., McDonald's investment bank, will be making markets in the debt and have potentially more lucrative trading opportunities.

Both offerings of \$100 million each are in registration with the Securities and Exchange Commission.

If McDonald's is wrong — and its offering prospectus notes its interpretation isn't binding on the Internal Revenue Service — the mistake would jeopardize the tax benefits to the qualified ESOP lenders.

The different interpretation
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Congress tackling retiree health

By Joel Chernoff

WASHINGTON — Congress might allow employers to pre-fund a portion of their retiree medical liabilities as part of legislation on asset reversions from terminated pension plans.

Proposals under discussion represent only a first step toward meeting employers' needs to fund their retiree health liabilities — estimated between \$200 billion and \$2 trillion. But a move by Congress would provide at least a

safety valve for employers who face having to place these liabilities on their balance sheets starting in 1992.

The dilemma of retiree health care funding — Page 15

Benefit experts describe the situation as very fluid. "If they're going to move, they're going to move very fast," said Meredith Miller, an employee benefit specialist for the AFL-CIO.

"I'm more optimistic now than I was even a month ago," said Rep. Rod Chandler, R-Wash., who acknowledged the outlook "still is not very good," primarily because of the potential impact on federal tax revenue.

But the issue got a big push when Rep. J.J. Pickle, D-Texas, who chairs the House Ways and Means Oversight Subcommittee, said his panel might try to resolve the asset reversion issue. While Mr. Pickle did not address retiree health issue directly, any solu-

tion to the plan termination issue could provide an opening for retiree health legislation.

Mr. Pickle is most concerned that employees are not receiving their full benefits when their plans are terminated in mid-career. A Labor Department study had found employees could lose up to 45% of their benefits because of plan terminations.

While Ways and Means members had spurned earlier attempts to deal with the reversion issue, their newfound
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Rep. Rod Chandler is cautiously optimistic on tax advantages for pre-funding health care.

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Proxy proposals gain support

Three of four proxy resolutions calling on Boeing Co., Kimberly-Clark Corp., Lockheed Corp. and Ford Motor Co. to opt out of Delaware's takeover law netted surprisingly strong shareholder support for first-time proposals.

At Boeing, the vote in favor of the opt-out plan was 19.3%; at Kimberly-Clark it was 16.1%; and at Lockheed, 22.9%, according to the Investor Responsibility Research Center, Washington. At Ford, the vote in favor was only 7.4%.

The sponsors — the New York City Retirement Systems at Boeing and Kimberly-Clark, the California Public Employees' Retirement System at Lockheed and the California State Teachers' Retirement System at Ford plan — generally were pleased with the results.

A majority of the outstanding votes was needed for approval. Under the Delaware law, companies may opt out of any or all of its takeover protections.

APPWP seeking simplified rules

WASHINGTON — A pension trade group is pushing a sweeping simplification of pension tax and fiduciary rules.

The effort drafted by an Association of Private Pension and Welfare Plans committee is motivated by a desire to rid pension and tax laws of obsolete and redundant rules. The trade group also wants to draft rules written for law-abiding plan sponsors, not for "the few isolated offenders," APPWP officials said.

Proposals being circulated among key congressmen include providing a uniform definition of highly compensated employees, instead of three as now exists; eliminating or modifying the minimum participation rules; repealing the non-discrimination test for 401(k) plans; eliminating or simplifying the top-heavy rules; easing distribution rules; and killing the summary annual report and simplifying the Form 5500 annual report.

APPWP officials hope to see at least some proposals attached to the budget reconciliation bill Congress will draft this summer.

U.S. Trust purchasing Dallas firm

NEW YORK — U.S. Trust Corp. has entered into an agreement to acquire Denker & Goodwin Inc., a Dallas investment adviser, for an undisclosed price.

Denker & Goodwin manages \$380 million for wealthy individuals and institutions in municipal bonds, U.S. government securities and equities.

The firm was founded in 1980 by Peter J. Denker and William J. Goodwin, who will remain chairman and president, respectively.

With the acquisition, Denker & Goodwin is "hoping to be able to help our clients by offering custodial and trustee services (through U.S. Trust) in addition to investment services," said Ann Davis, operations manager.

The deal is scheduled to close in midsummer, subject to federal regulatory approval.

Fund taps international manager

RICHMOND, Va. — Ethyl Corp., in its first foray into international investments, has hired Oechsle International Advisors, Boston, to run an undisclosed amount in an active international equity portfolio.

According to Lloyd Andrew, Ethyl's former chief financial officer who now consults for the \$600 million pension fund, fund executives are considering another international placement.

"It isn't just one reason" for the international move, Mr. Andrew said. "Diversification is good. (International) returns have been good. It is no longer just a domestic market; it is a world market. You can't ignore that fact."

Mr. Andrew said the money came from a reduction in the allocation to a domestic equity manager he would not identify.

N.D. plan starts overseas foray

BISMARCK, N.D. — The \$400 million North Dakota Teachers' Fund for Retirement interviewed finalists May 23-24 for its initial \$20 million plunge into international investing.

Interviewed were: Axe Core Investors Inc., Tarrytown, N.Y.; Baring International Investment Ltd., London; First Chicago Investment Advisors, Chicago; Morgan Grenfell Investment Services Ltd., London; Northern Investment Management Co., Chicago; Schroder Capital Management International, New York; and State Street Bank and Trust Co., Boston, according to Leroy Gilbertson, now head of the Public Employees Retirement System and who will become chief investment officer of the North Dakota Retirement and Investment Board July 1.

The fund is seeking managers for international equity and fixed-income and currency overlay programs.

The retirement board oversees the investments of the teachers' fund and after July 1, also will oversee the public employees' investments.

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Execs on the move

4 financial officials take on new responsibilities

Get your scorecards ready. Executive shifts are taking place at United Airlines Inc., the City & County of San Francisco Employees Retirement System, Motorola Inc. and the Oregon Public Employees Retirement System.

John C. Pope, chief financial officer of United Airlines, Chicago, is moving over to head up the airline's marketing and planning effort. He will retain the titles of executive vice president and

director of UAL Corp., United's parent company.

United will name a new chief financial officer as quickly as possible, a spokesman said.

Mr. Pope will be in charge of United's efforts to expand operations and increase market share, a spokesman said. He replaces John R. Zeeman, who was named chief executive officer of Galileo, a London-based computer reservations consortium partly owned by United.

Mr. Pope's new assignment is seen by industry observers as an important step up the ladder toward the presidency of an airline. Before becoming president, chairman and chief executive officer of their respective companies, AMR Corp.'s Robert C. Crandall and Pan Am Corp.'s Thomas Plaskett held finance, then marketing jobs at American Airlines.

Mr. Pope joined United in January 1988. He previously was senior vice president-finance and chief financial officer of AMR, Fort Worth, Texas, the parent company of American Airlines.

Mr. Pope was unavailable for comment.

Kenneth L. Shaffer, investment officer with the approximately \$3.48 billion State of Alaska Re-

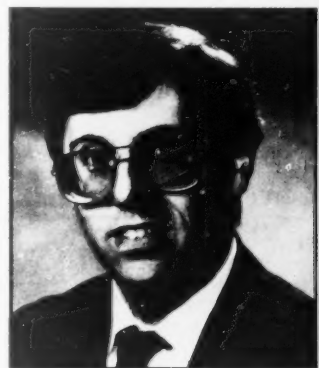
tirement Systems, Juneau, has been named chief investment officer for the \$3.7 billion City & County of San Francisco Employees Retirement System.

Mr. Shaffer, one of 50 candidates for the job, will receive \$95,400 annually plus benefits. He replaces DeWitt Bowman, who in February became chief investment officer for the \$51 billion California Employees' Retirement

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John C. Pope is the new marketing and planning chief at United Airlines.



William H.S. Preece returns to the corporate side of the fence, this time at Motorola.

Treasury mulls LBO debt curbs

By Joel Chernoff

WASHINGTON — A Treasury Department official has signaled the government's interest in curbing deductions for zero-coupon and payment-in-kind bonds in leveraged buy-outs — particularly those held by tax-exempt institutions and foreign entities.

If the deductibility is curbed, price tags for larger leveraged buy-outs could fall because of the resulting increase in taxes.

But some observers said the Treasury Department is launching an indirect attack on pension funds and other tax-exempt institutions.

There's a notion that pension funds are the last tax loophole to be closed, said Howard Gellis, managing director of Equitable Capital Management Corp., New York. "It's not a loophole, it's social policy," he said.

At a May 16 House Ways and Means Committee hearing on curbing leveraged buy-out activity, John G. Wilkins, the Treasury Department's acting assistant secretary for tax policy, also expressed concern about certain tax preferences granted to employee stock ownership plans, especially in light of the growing revenue loss as the use of ESOPs as takeover defenses soars.

The administration has no plans now to repeal ESOP-related tax benefits. "The last thing in the world we want to do is to see ESOPs harmed," Mr. Wilkins said.

But ESOP experts are wary, expecting efforts to reduce tax benefits.

"I predict there will be some type of vote" on ESOP-related tax benefits this year, said David Binns, executive director of The ESOP Association, Washington.

The Treasury Department largely rejected, however, options developed by the Ways and Means

Committee designed to restrict leveraged buy-out activity. Mr. Wilkins said the area needs "further study" on how tax treatment of corporate debt and equity affect U.S. competitiveness in world markets.

Committee Chairman Dan Rostenkowski, D-Ill., lambasted the department for not coming up with a more aggressive posture on limiting leveraged buy-outs.

"I think we are back to square one," Mr. Rostenkowski said. "In fact, Mr. Secretary, I think you are retreating," he added, citing Treasury Secretary Nicholas Brady's previous comments concerning adjusting the tax preferences for debt and equity.

The only area where the Treasury Department favors a change in the law is for certain original-issue discount bonds, which include zero-coupon and payment-in-kind bonds. PIK bonds pay interest in additional bonds, usually for the first several years.

Original-issue discount bonds are used heavily in leveraged buy-outs because interest payments are not paid out for several years, thus enabling issuers to conserve cash. Deductions, however, accrue currently, giving issuers sizable tax breaks in advance of paying out interest.

In the mammoth buy-out of RJR Nabisco Inc., more than one-third of the \$25 billion financing involved discounted or PIK securities. RJR's use of \$4 billion in preferred PIKs doubled the size of the market for that security.

Mr. Wilkins suggested interest deductions for OIDs be deferred until interest actually is paid out, "where there is a substantial risk of default."

"Concerns about current deductibility of OIDs are particularly strong when the instrument is held by a tax-exempt organization or a foreign person, because

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Seidman against BIC limit

By Fred Williams

WASHINGTON — William Seidman, chairman of the Federal Deposit Insurance Corp., is opposed to an insurance industry initiative to remove FDIC protection from bank investment contracts for two years pending a congressional study.

The moratorium is contained in the House version of the thrift industry rescue bill as an amendment offered by Rep. Charles Schumer, D-N.Y. (Pensions & Investment Age, May 1).

Responding to an inquiry from Rep. Stephen L. Neal, D-N.C., a member of the House Banking subcommittee, Mr. Seidman said "the FDIC emphatically believes there is no significant risk to the insurance fund in passing through coverage to beneficial owners of pension plans" that purchase BICs.

The insurance industry has been lobbying hard to remove pass-through coverage of up to \$100,000 per participant and has pushed for the moratorium on BICs issued after April 6 to prevent the buildup of potentially large FDIC insurance fund liabilities until the issue is resolved.

"We are extremely troubled by the Schumer amendment for several reasons," Mr. Seidman said in his response to Mr. Neal. "First, it calls into question the deposit insurance coverage applicable to the substantial bank deposit market represented by deposit products held by pension and profit-sharing plans."

He pointed to a recent Fed-

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Longer is not better Medium-term bonds befit pension funds' needs

By Edward R. Bedrosian
and Edward M. Safran

Long-term government bonds are a bad investment. In terms of risk and return, fixed-income securities of moderate maturity offer investors a better deal.

For most institutional investors, the fixed-income asset class is expected to provide consistent, real returns, a sort of anchor to windward. The evidence demonstrates fixed-income portfolios of moderate maturity will achieve this objective better than those of long maturities.

Long-term government bonds haven't been the good refuge for risk-averse investors. They also

have not performed well for those investors wishing to increase their risk exposure by extending the maturity of their fixed-income portfolio. If pension sponsors want to increase the risk exposure of their funds, it is better to shift assets out of fixed income and into a riskier asset class with higher return potential (e.g., common stocks).

Even dedication and immunization, despite pension sponsors' widespread use of these asset-liability matching strategies, are inappropriate portfolio techniques for inflation-related liabilities, namely, defined benefit pension obligations.

Long-term bonds have a place

in portfolios, but not for most pension sponsors.

Our view is founded on our investment experience evaluating risk-return characteristics of fixed-income securities in all sectors of the market.

The historical return of long-term government bonds is the lowest of the major financial asset classes (aside from Treasury bills), and their risk, while much lower than that of stocks, is the highest of the major fixed-income categories, including long-term corporate bonds.

Their performance turns capital market theory upside down. With long-term bonds, more risk has produced less return.

Credit risk aside, we analyzed intermediate-term (five years) and long-term (20 years) Treasury securities, drawing on research of other firms as well as our own. Each of the following analyses bolsters our view in favor of intermediate-maturity bonds.

According to the rates of return studies of Ibbotson Associates Inc., Chicago, intermediate Treasury securities outperformed long Treasury bonds for the 63-year period ended in 1988. As Table A shows, intermediate bonds returned more than long bonds (4.8% vs. 4.4%) with less risk (a standard deviation of 5.5% vs. 8.5%).

Inflation explains much of the difference. Table B divides the 63 years into six subperiods of inflation or deflation. Investors should note the spreads between intermediate and long bonds. In most subperiods, long bonds outperformed intermediate bonds by small amounts. During the high inflation subperiod of 1966 to 1980, however, intermediate bonds substantially outperformed long bonds, more than offsetting the subperiods long bonds were slightly ahead. The 15-year high

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Edward M. Safran, left, and Edward R. Bedrosian are president and chairman, respectively, of Merganser Capital Management Corp., Cambridge, Mass.

TABLE A

Comparative performance 1926-'88

	Compound annual return	Standard deviation
Common stocks	10 %	20.9%
Small company stocks	12.3	35.6
Long-term corporate bonds	5	8.4
Long-term Treasuries	4.4	8.5
Intermediate-term Treasuries	4.8	5.5
Treasury bills	3.5	3.3
Inflation rates	3.1	4.8

Source: Ibbotson Associates Inc., Chicago

TABLE B

Intermediate- vs. long-term Treasuries

Annual rates of return				
	Inflation status	Inflation	Intermediate	Long
1926-'32	Deflation	-4.4%	4.2%	5 %
1933-'40	Low	0.9	4.5	5
1941-'51*	High	5.9	1.5	2
1952-'65	Low	1.3	2.7	2.1
1966-'80	High	6.9	5.5	2.6
1981-'88	Disinflation	4.3	12.8	14.2
1926-'88		3.1	4.8	4.4

*Period of artificially low interest rates

Source: Ibbotson Associates Inc., Chicago

High yields protect 'junk' in recession

By Dimitri Raftopoulos

Whenever the next recession arrives — so far it's been anticipated for 40 months — it will assuredly affect the performance of junk bonds. The question is, how badly?

I suggest investors and potential investors who fear the uncertainties of junk bonds take a fresh look at the impressive level of protection provided by the high yields of the securities.

Fear of untold losses in the anticipated recession probably is holding back many potential investors despite the attractive performance in recent years.

An analogy is sometimes drawn between the next recession and the Great Depression. But what is the likelihood that, for example, authorities would contract the money supply in a crisis (as they did in the '30s), when we know from the experience of the 1987 stock market crash the Federal Reserve Board took steps to maintain the flow of credit? Such a sit-

uation today more likely would lead to rapid inflation, which would be a boon to issuers of junk bonds.

In considering the impact of recession on junk bond performance, one must distinguish between defaults and declines in prices.

The decline in return on junk bonds, in general, will be influenced far more by a fall in prices than by an increase in defaults. Widespread fear is likely to trigger selling at prices unrelated to risks. Many junk bond portfolios financed with borrowed funds and junk bond mutual funds driven to forced redemptions will, for a short period, further depress prices by their urgent need to raise cash.

But price declines are not defaults, and price declines increase yields. If an average yield on junk bonds of 14% (as it has been recently) is insufficient compensation for higher expected default rates, will a yield of 16% be enough, or 18% or 20%?



Dimitri Raftopoulos is vice president-research at SEI Corp., New York. This article is adapted from a lengthier analysis.

During a short period of panic or forced selling by a small number of holders, the majority of potential transactors are not likely to react immediately. As every successively lower price implies a still higher yield, a point must be reached where the yield advantage over investment-grade bonds, risk and all, proves irre-

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Index Fund Management

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Yields protect

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sistibly attractive.

In the short history of the modern junk bond market, there were three occasions for observing its behavior encountering a bad surprise. The LTV Corp.'s bankruptcy filing in mid-July 1986; the Ivan Boesky scandal later that year; and the 1987 crash.

In each case, the junk bond market went into a rapid decline. The price decline in the 1987 crash environment was the steepest and the most instructive because it reflected reaction to a traumatic event heralding extraordinary economic uncertainty and accompanying flight to quality. In all three occasions, however, junk bond prices rebounded when the apprehension passed.

In a steep recession, the greatest danger to the junk bond market might lie not with defaults of issuers but with failure of market-makers.

This type of risk is extraneous to the risk of junk bonds as investments, and it's a temporary condition. Except for the marginal impact on pending trades, it wouldn't affect non-leveraged investors who can wait to ride out a market-making crisis. Leveraged investors and portfolios managed aggressively, however, might be significantly affected by liquidity pressures.

Even during a recession, several important sources of support will come into play to restrain losses.

Often overlooked is the favorable effect of income reinvestment

at higher yields, especially impressive for junk bonds because their high incomes magnify the importance of reinvestment for long-term returns. That higher realized compound yield helps offset adverse returns from an increase in default rates.

Market prices generally move in anticipation of economic developments. Junk prices would begin to decline before the onset of a recession, likely with the economy on the upswing and general interest rates high and rising. But issuers can't default in anticipation.

During a recession, defaults will rise. At the same time, interest rates decline in a recession. While weaker issuers are failing, stronger issuers will be refinancing at lower rates, improving their cash flow and credit.

In a series of hypothetical recession scenarios for junk bond portfolio performance over a year,

I've found the high income has a powerful cushioning effect even under very adverse conditions. In the scenarios, I've assumed initial average yields of 14% and 15%; general market price declines over one year of 15%, 20% and 25%; and default rates of 5% and 10%.

By the end of one year, all the scenarios show how much yields have risen from their initial levels. In the mildest scenario, yields rise to 16.7% from 14% and prices fall 16.3%, producing a total return of -4.1%. In the worst scenario, yields rise to 20.4% and prices fall 26.5%, producing a total return of -13.6%.

A 25% price decline and 10% default rate are unlikely to happen even in a severe recession. The influences likely to restrain default rate increases, as I've mentioned, indicate the 5% default rate is more plausible. Excluding defaults on investment-

grade bonds, the highest single-year default rates in the last 15 years were 4.3% in 1977, 3.1% in 1982 and 3.4% in 1986.

As for the total rate of return, a Drexel Burnham Lambert Inc. study shows it was 0.9% for 1980 (the year anticipating the recession), implying a loss of principal of 12% to 13%. For 1981, junk bonds returned a positive 2.7%, implying a principal loss of about 12.5%. For 1982, they returned 36.3% as prices rebounded sharply in anticipation of the recession's end, despite the peak in the default rate. For 1983, junk bonds returned 19.73%.

A plausible estimate of junk bond performance in a deep recession would be a 20% price loss coinciding with a 7% default. Such a combination would produce an estimated annual return of -9.5%.

Negative returns are never agreeable, so it is important to keep them in perspective as part of a considerably longer period of, I hope, positive investment experience.

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inflation subperiod of 1966-1980 was mainly responsible for the superior 63-year performance of intermediate bonds. While this same phenomenon did not occur in the high inflation subperiod of 1941-1951, we don't view the results of these years as meaningful because the government kept interest rates artificially low.

We found further evidence of the superiority of intermediate maturity securities by comparing returns in 10-year periods.

For all the 34 consecutive 10-year periods since 1946, intermediate bonds provided superior returns to long-term bonds. Before 1946, for most of the 10-year periods beginning with 1926, long bonds outperformed intermediate bonds. The reason for the change: Since World War II, there has been a consistent rise in interest rates and inflation; and as a result, long bonds have had greater price erosion than intermediate bonds. We believe this post-1946 performance is caused by fundamental economic factors still at work.

Going longer gives investors little incremental yield, as Salomon Brothers Inc., New York, shows in a report depicting the Treasury yield curve for the 28-year period of 1960-1987. The yield on a two-year Treasury note averaged 7.7% (or 95% of the 30-year bond yield of 8.14%). The five-year Treasury note brought 8.03% (or 99% of the 33-year bond yield).

That much of the increase in yield occurs within the first few years for a normal, positively sloped yield curve is consistent with most investors' expectations. What is surprising in the Salomon report is how early the flatness occurs in this average curve.

There was virtually no incremental return beyond five years; and from a risk-return perspective, extending beyond two years was of little value.

We see two reasons for investing long. First, long-term fixed-income securities might be the lowest risk investment to cover known liabilities within specific time periods. But if the liabilities are variable, beware. Second, long securities give market-timers the big price changes they want. Market-timers may produce superior performance, but they begin with a handicap: Long-term bonds have produced higher risk and lower returns than moderate-maturity securities.

Swiss opening to foreigners

By John Parry

Bank changes takeover attitude

ZURICH, Switzerland — In a move many observers think will produce a radical rethinking of Swiss companies' attitudes toward foreign ownership, the country's largest bank has come out in favor of a more open attitude to takeovers by foreigners.

Nikolaus Senn, chairman of the board of Union Bank of Switzerland, also said companies should become more open in their relationship with shareholders. The forthcoming unification of the European markets in 1992 is not going to permit Swiss companies to keep themselves aloof from international mergers and acquisitions, he said in a speech earlier this month.

While industrial companies will have to swim with the international tide, Swiss banks should maintain their current hostile attitude to foreign takeovers.

"Swiss banking authorities should have a veto over takeovers of controlling interests in Swiss banks," he told the Swiss-American

Chamber of Commerce in the speech, which banking circles said was a major step forward in bank thinking.

"The best solution is to do what most other countries do — let banks operate under regular company and banking law, but maintain some authority over ownership with a banking commission."

Industrial companies, however, cannot stand aside and block foreign participation — or even takeovers, he said. The words were seen by banking officials as supporting the position taken in November by Nestlé S.A., the Swiss-based food multinational, when it announced it would allow foreigners to purchase its registered shares, which had been restricted to Swiss citizens (*Pensions & Investment Age*, Dec. 12).

Aside from one small engineering company, no company has followed Nestlé's example. But banking circles said Mr.

Senn's endorsement of the principle — although he did not mention Nestlé by name — could lead other major Swiss industrial firms to open their registered shares to foreigners.

The three Swiss-based chemical and pharmaceutical multinationals — CIBA-GEIGY, Sandoz and F. Hoffmann La Roche and Co. — all are rumored to be considering taking the Nestlé path but none has done so as yet.

Foreign investors must have the right to buy into Swiss companies, Mr. Senn told the Chamber of Commerce, because those companies themselves have to rely on foreign acquisitions for growth. The European community, in a warning to Switzerland about the effects of 1992, has said it would prevent Swiss companies from buying up companies in the 12-nation European Community unless Swiss law is changed to pre-

vent discrimination within Switzerland. The law currently is being revised and might change soon, according to Mr. Senn.

The change at Nestlé allowing foreigners to hold registered shares was expected to be approved at the company's annual meeting May 25.

Helmut Maucher, Nestlé managing director, said the change is necessary because Nestlé does most of its business in other countries and its management is increasingly non-Swiss. Mr. Maucher, for example, is a German citizen.

This point was supported by Mr. Senn in his speech. "Many large Swiss companies give the impression of truly international firms that just happen to have their headquarters in Switzerland," he said. "Thus it is difficult to see that national interests or national security will be endangered by registering foreign investors. The practice of limiting foreign ownership is seen by many as simply a way to assure that existing management remains in control."

Active strategies win Japanese exposure, rising dollar hurt indexers

By Margaret Price

In the first quarter, active international and global money managers dethroned indexers to become the top-performing managers in Pensions & Investments' Performance Evaluation Report.

For many international managers, the relatively poor performance of the Japanese equity market, coupled with the dollar's climb helped make the difference. International index funds, which often had benefited from large exposures to Japan, saw the decline in Japan's market reducing many of their returns to less than 1%, while the same development helped lift the standings of at least some active managers who steered clear of Japan.

The quarter's two best-performing global/international funds in the PIPER universe — Associated Bank's Worldwide Fund, which posted a 9.93% return, and WorldInvest Ltd.'s International Pooled Equity Fund,

which reported 6.91% — both had limited exposures to Japan in the first quarter.

The \$964 million international index equity fund of Wells Fargo Investment Advisors, San Francisco — which was No. 1 for the quarter and year ended Dec. 31 — dropped abruptly in the first quarter of 1989. For the quarter, the fund returned -0.1%; for the year ended March 31, the fund returned 11.2%.

Throughout 1988 and thus far this year, the Associated Bank fund had no Japanese holdings, reported Neil Braun, vice president-trust investments of the Neenah, Wis., bank.

The \$18.5 million fund, which uses Templeton Investment Counsel Inc., Fort Lauderdale, Fla., as an investment adviser, also was PIPER's top international performer for the year ended March 31, with a 19.8% return. WorldInvest's \$68 million fund again came in second, reporting a gain of 17.6%.

In comparison, the Morgan Stanley Capital International Europe Australia Far East Index rose 0.3% in dollar terms in the first quarter and the FT-Actuaries Europe-Pacific Index rose 0.24%. For the 12 months ended March 31, the EAFE rose 28.6% and the FT-Actuaries Europe-Pacific rose 11.23%.

Money managers cited the rising dollar as the leading influence on all international funds in the first quarter. The dollar's roughly 6% advance dampened the performance of all international investments that were not hedged back to dollars. The rise also carried a second problem: fears that foreign countries might raise interest rates to defend their currencies.

Spillover from the latter concern created problems for non-dollar bond investors. In the first quarter, falling bond markets in some cases along with the rising dollar, helped push international fixed-income funds to the bottom

Continued on page 40

Managers drop holdings in cash

EDINBURGH, Scotland — Some international managers lessened their cash holdings and increased slightly holdings in Japan and the Far East during the first quarter.

According to a survey of 101 international managers by The World Markets Co. Ltd., Edinburgh, Scotland, managers dropped the cash holdings in their international portfolios during the first quarter to 7% from 9% at the end of 1988.

Among those managers, the average holdings in Japan rose to 36% from 35% at the end of 1988, and average holdings in the Far East rose to 43% from 41%.

The underweightings in Japan were one reason given for the average active manager bettering the EAFE returns.

The median manager in World Markets' survey returned 2.2% for the three months, compared with the Morgan Stanley Capital International Europe Australia Far East Index return of 0.33%. (The EAFE return is that reported in Pensions & Investments' Performance Evaluation Report.)

The EAFE return occurred despite a U.S. dollar-adjusted drop of 1.3% in the Japanese market, which accounts for fully 63.7% of EAFE.

"Within EAFE, the U.K. (United Kingdom), with its 9.3% return for U.S. investors, offset the negative influence of Japan and kept the overall EAFE return positive," according to a "Flash Report" from World Markets. (During the quarter, the average U.K. weighting in the

World Markets universe rose to 14% from 13%.)

The United Kingdom now accounts for 12.6% of the EAFE, according to Morgan Stanley, up from 11.6% at year-end 1988. Continental Europe accounted for 19.4% of the EAFE market in the first quarter, according to Morgan Stanley.

West Germany comprised 4.1% of EAFE at the end of the quarter compared with 4.3% at year-end '88; France made up 3.8%, the same as its year-end weighting; Switzerland, 2.2% vs. 2.3%; Italy, 2.1% vs. 2.2%; and Spain, 1.4% vs. 1.5%.

The World Markets survey indicated its average manager had a rounded 9% weighting in West Germany; 5% in France; 4% in Switzerland; 2% in Italy; and 2% in Spain.

World Markets survey respondents had an average 5% in Norway, up one percentage point. Norway had the best returns for the quarter, according to Morgan Stanley, at 24.7%. Its weighting in EAFE at the end of the quarter rose to 0.4% from 0.3% at the end of 1988.

According to a survey from InterSec Research Corp., Stamford, Conn., the median portfolio in its 130-manager non-U.S. equity universe returned 2.15% for the first quarter.

The median exposure to Japan was 39%, down from 39.3% at the start of the quarter; in the United Kingdom, the median holding was 15%, up from 13.4% at the quarter's start; cash holdings rose to 3.2% from 1.9%; and holdings in the Pacific markets without Japan rose to 9.4% from 8.5% at the start of the quarter.

Top-performing EAFE countries

	1st quarter return	EAFE weighting	% of average manager portfolio
Norway	24.7%	0.4%	5%
Singapore/Malaysia	14.3	0.8	2
Austria	13.7	0.2	NA
Hong Kong	13.3	1.3	3
Sweden	11.1	1.5	1

Source: Morgan Stanley & Co. and The World Markets Co. Ltd.

Commingled international funds 3-month returns

	%
Assoc. Bank Neenah (World), Wis.	9.9
WorldInvest (Eq.), N.Y.	6.9
Wilmington Trust (Eq.), Del.	6.1
Wellington Trust (Emerg. eq.)	5.0
Lincoln Nat'l (SA 22), Ind.	4.9
Trust Co. of the West (Global)	4.5
Bankers Trust (Eq.), N.Y.	4.1
Citicorp Invest. (Eq.), N.Y.	3.7
Fidelity Mgmt. (Overseas eq.)	3.0
Putnam Cos., Mass.	2.9
Marine Midland (Eq.), N.Y.	2.8
Travelers (Eq.), Conn.	2.7
Bessemer Trust (E), N.Y.	2.6
MSCI World Index	2.4
Wellington Trust (Stock), Mass.	2.1
PCM Int'l (Print eq.), N.J.	2.0
Wellington Trust (Pacific Basin)	1.6
First Chicago (Eq.)	1.6
NCNB Texas (Stock)	1.6
Equitable Capital (Port. 20), N.Y.	1.2
First Chicago (\$ fixed)	1.0
Aetna Capital (Eq.), Conn.	0.9
Union Bank (Inv. eq.), Calif.	0.9
IDS Trust (Coll. eq.), Minn.	0.8
MSCI EAFE Index	0.3
State Street Bank (Index), Mass.	0.3
Travelers (Index), Conn.	0.2

Provident Capital (Low p/e), Pa.	0.2
CIGNA Corp. (Eq.), Conn.	0.2
Confederation Life (Stock), Ga.	0.1
Wells Fargo (Eq.), Calif.	-0.1
Connecticut Mutual (Overseas)	-0.1
Prudential (Foreign stock), N.J.	-0.2
Chase Investors (Eq.), N.Y.	-0.3
Morgan Guaranty (Eq.), N.Y.	-0.3
Chase Investors (EAFE index)	-0.5
IAA Trust (CTF-I), Ill.	-0.7
Harris Trust (Eq.), Ill.	-0.8
PCM Int'l (Global yield), N.J.	-1.2
Boatmen's Trust (Coll. W), Mo.	-1.4
The Principal (Stock), Iowa	-1.7
PCM Int'l (Global bond), N.J.	-2.3
WorldInvest (Fixed), N.Y.	-2.7
Morgan Guaranty (Bond), N.Y.	-3.4
First Chicago (Non-\$ fixed)	-3.7
Citicorp Invest. (Fixed), N.Y.	-4.2
PCM Int'l (Foreign bond), N.J.	-5.8
Chase Investors (Fixed), N.Y.	-5.9

1-year returns

	%
Assoc. Bank Neenah (World)	19.8
WorldInvest (Eq.), N.Y.	17.7
Wilmington Trust (Coll. eq.), Del.	15.5
The Principal (Stock), Iowa	15.5
Bankers Trust (Eq.), N.Y.	13.9
Trust Co. of the West (Global)	13.6
MSCI World Index	13.6

Provident Capital (Low p/e), Pa.	13.3
First Chicago (Eq.)	12.1
MSCI EAFE Index	11.9
Wellington Trust (Emerg. eq.)	11.6
Prudential (Foreign stock), N.J.	11.6
Wells Fargo (Eq.), Calif.	11.2
State Street Bank (Index), Mass.	11.1
CIGNA Corp. (Eq.), Conn.	10.9
Travelers (Index), Conn.	10.8
Chase Investors (EAFE index)	10.7
PCM Int'l (Global yield), N.J.	10.6
Fidelity Mgmt. (Overseas eq.)	10.5
Wellington Trust (Stock), Mass.	9.8
Putnam Cos., Mass.	9.8
Lincoln Nat'l (SA 22), Ind.	9.7
Bessemer Trust (E), N.Y.	9.4
Chase Investors (Eq.), N.Y.	9.4
Morgan Guaranty (Eq.), N.Y.	8.8
PCM Int'l (Print eq.), N.J.	8.7
Confederation Life (Stock), Ga.	8.5
Travelers (Eq.), Conn.	8.4
Union Bank (Inv. eq.), Calif.	7.6
Citicorp Invest. (Eq.), N.Y.	7.5
Wellington Trust (Pacific Basin)	6.8
NCNB Texas (Stock)	6.7
IDS Trust (Coll. eq.), Minn.	6.4
Boatmen's Trust (Coll. W), Mo.	6.2
Aetna Capital (Eq.), Conn.	5.9
First Chicago (\$ fixed)	5.8
PCM Int'l (Global bond), N.J.	5.3
Harris Trust (Eq.), Ill.	4.3

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Indexers hurt

Continued from page 39

of the performance heap. In the 46-fund PIPER universe, the lowest-performing seven funds were international/global bond funds.

In last place was Chase Investors' International Fixed Income Fund with -5.88%. That compares with the -5.82% posted by the unhedged Salomon Brothers World Government Bond Index minus the United States.

Chase Investors' International Fixed Income Fund employs very limited amounts of hedging. According to Roger Bartley, executive director of the international department of Chase Investors in London, the fund is "clearly designed" for two types of participants: "longer-term investors who are looking for more risk diversification (beyond dollar investments) and those who expect the dollar to decline."

In the case of Associated Bank's top-performing Worldwide Fund, the dollar's rise was one factor that apparently helped the fund's performance. The fund had an almost 40% U.S. weighting, about 8% invested in the Hong Kong — whose currency movements are closely linked with the dollar — and about 10% in cash. Thus, "there was almost 60% of the portfolio in dollar-related assets," Mr. Braun noted.

In non-dollar related assets, the fund had about 12% in Canada, 10% in the United Kingdom, 10% in Australia, and about 10% collectively in West Germany, Norway and Spain. According to Mr. Braun, Templeton uses a value investing strategy.

Second-place WorldInvest and third-place Wilmington Trust Co.'s International Collective Equity Fund both use top-down approaches, while fourth placed Wellington International Investors' Emerging Company Stock Fund relied on value investing.

Beginning late last year, WorldInvest's Pooled Equity Fund

began betting U.S. interest rates were about to peak. The firm gradually reduced some of its European exposures and modestly lifted allocations to markets that had "fortunes tied to that of the U.S.," said Mark Beale, a WorldInvest director in London.

For the first quarter, the fund maintained weightings of about 25% in the United Kingdom, about 10% in Hong Kong, 8% each in Australia, Canada and France, 5% each in West Germany, the Netherlands, Japan and Switzerland, with smaller amounts in several other countries. According to Mr. Beale, the fund has been concentrating on "cyclical stocks that would benefit from growth in world trade and strong GNP growth."

Wilmington Trust Co., Wilmington, Del., employs an unusual twist in its collective equity fund: "We're one of the few, if not the only, international funds that use multiple (outside) investment advisers," said Catherine Gordon, portfolio manager of the \$8.1 million fund. In the first quarter, the fund — which also has a very small percent (less than 1%) invested in fixed income — posted a 6.06% return.

The fund's outside advisers are Clemente Capital Management Inc. and Scudder, Stevens & Clark, both of New York; and Edinburgh Fund Managers, Edinburgh, Scotland. One benefit of using multiple managers is the lessened overall volatility of the portfolio, she said.

In the first quarter, the fund had 9% in cash, with the equities distributed roughly 30% in Japan, down from about 40% at year-end 1988; just more than 14% in the United Kingdom; almost 10% in Hong Kong; 4.6% in Singapore/Malaysia; and smaller amounts in a number of continental European countries and Australia.

Wellington Trust Co.'s International Emerging Stock Portfolio, run by Wellington International

Investors, placed fourth for the quarter with a 4.97% return. The approximately \$10 million Boston-based fund, which invests in companies of \$250 million or less in annual revenue, got a boost from foreign takeover and merger situations, noted Marie-Claude Bernal, a Wellington vice president. "I am a value investor. I like

fast-growing small companies with a market niche, especially if there is a possibility that they are takeovers, so that I can realize profits quickly," Ms. Bernal said.

In the first quarter, "I was particularly lucky," she said. "Close to 7% of total assets in the portfolio, or eight stocks, were involved with takeover situations."

But the dollar's rise did not prove beneficial for international small stocks. "Most of my holdings are currency-sensitive," Ms. Bernal said. "I would have been up about 10% for the quarter if I had hedged holdings into dollars." But that's a tactic she tries to avoid: "I'm not trying to play the ups and downs of currencies."

Continued from page 39

Marine Midland (Eq.), N.Y.	3.0
NCNB Texas (Stock)	19.4
Wellington Trust (Stock), Mass.	19.2
Citicorp Invst. (Eq.), N.Y.	18.6
PCM Int'l (Global bond), N.J.	18.4
Boatmen's Trust (Coll. W), Mo.	18.3
Union Bank (Inv. eq.), Calif.	18.1
Fidelity Mgmt. (Overseas eq.)	18.0
First Chicago (Non-\$ fixed)	18.0
Aetna Capital (Eq.), Conn.	17.4
Chase Investors (Fixed), N.Y.	17.2
Equitable Capital (Port. 20), N.Y.	17.2
PCM Int'l (Print eq.), N.J.	16.9
Morgan Guaranty (Eq.), N.Y.	16.9
PCM Int'l (Foreign bond), N.J.	16.7
IDS Trust (Coll. eq.), Minn.	16.3
WorldInvest (Fixed), N.Y.	16.1
Wellington Trust (Emerg. eq.)	15.0
Morgan Guaranty (Bond), N.Y.	14.6
Putnam Cos., Mass.	13.9
Citicorp Invst. (Fixed), N.Y.	11.3
First Chicago (\$ fixed)	7.0

3-year returns

	%
Wellington Trust (Pacific Basin)	30.7
State Street Bank (Index), Mass.	28.7
Wells Fargo (Eq.), Calif.	28.7
Chase Investors (EAFE index)	28.3
MSCI EAFE Index	28.2
Prudential (Foreign stock), N.J.	28.0
Provident Capital (Low p/e), Pa.	25.8
Bankers Trust (Eq.), N.Y.	24.3
Lincoln Nat'l (SA 22), Ind.	23.0
First Chicago (Eq.)	22.7
Chase Investors (Eq.), N.Y.	22.5
CIGNA Corp. (Eq.), Conn.	21.8
WorldInvest (Eq.), N.Y.	21.7
Confederation Life (Stock), Ga.	21.7
Bessemer Trust (E), N.Y.	21.6
MSCI World Index	20.3

Marine Midland (Eq.), N.Y.	19.6
NCNB Texas (Stock)	19.4
Wellington Trust (Stock), Mass.	19.2
Citicorp Invst. (Eq.), N.Y.	18.6
PCM Int'l (Global bond), N.J.	18.4
Boatmen's Trust (Coll. W), Mo.	18.3
Union Bank (Inv. eq.), Calif.	18.1
Fidelity Mgmt. (Overseas eq.)	18.0
First Chicago (Non-\$ fixed)	18.0
Aetna Capital (Eq.), Conn.	17.4
Chase Investors (Fixed), N.Y.	17.2
Equitable Capital (Port. 20), N.Y.	17.2
PCM Int'l (Print eq.), N.J.	16.9
Morgan Guaranty (Eq.), N.Y.	16.9
PCM Int'l (Foreign bond), N.J.	16.7
IDS Trust (Coll. eq.), Minn.	16.3
WorldInvest (Fixed), N.Y.	16.1
Wellington Trust (Emerg. eq.)	15.0
Morgan Guaranty (Bond), N.Y.	14.6
Putnam Cos., Mass.	13.9
Citicorp Invst. (Fixed), N.Y.	11.3
First Chicago (\$ fixed)	7.0

5-year returns

	%
Chase Investors (EAFE index)	32.3
MSCI EAFE Index	32.0
Wells Fargo (Eq.), Calif.	31.3
WorldInvest (Eq.), N.Y.	29.9
Bankers Trust (Eq.), N.Y.	28.2

10-year returns

	%
MSCI EAFE Index	22.0
First Chicago (Eq.)	19.9
Putnam Cos., Mass.	19.5
MSCI World Index	19.1
Citicorp Invst. (Eq.), N.Y.	18.8
Morgan Guaranty (Eq.), N.Y.	17.6

NEWS BRIEFS

Divestiture is urged

ADELPHI, Md. — The University of Maryland System's finance committee has recommended divestiture of all South Africa-related securities, a move that likely will be approved by the full board of regents June 7.

The university's \$45 million endowment fund has about \$11 million in stocks and bonds of U.S. companies with direct or indirect ties to South Africa, said Donna H. Cunningham, assistant vice chancellor-financial affairs and chief financial officer. Deadline for divestiture will be Dec. 15.

GIC investors named

NEW YORK — MONY Financial Services has obtained allocations totaling \$17.6 million in guaranteed investment contracts from three clients.

Sandy Trimble, MONY's manager of pension services, said the investors, and the amounts committed, are: Fleetwood Enterprises Inc., Riverside Calif., \$5 million; First Interstate Bank, Los Angeles, \$7.6 million; and Chicago Title & Trust Co., \$5 million.

Commenting on Fleetwood Enterprises' investment, Thomas Bayless, director of taxes, said the allocation — Fleetwood's first with MONY — was made for a number of reasons, including the "attractive interest rate" offered. He declined to elaborate.

Thomas Marthaler, portfolio manager at Chicago Title & Trust Co., said "we are an investment advisory firm. We managed GIC accounts for clients, and this" \$5 million GIC purchase "was the latest GIC purchase from MONY to be used for a number of our clients' 401(k) plans."

Officials at First Interstate Bank could not be reached for comment.

Ferro forms ESOP

CLEVELAND — Ferro Corp. formed a \$70.5 million leveraged employee stock ownership plan, boosting to 10% from 2% the

amount of the company's stock employees control.

John V. Goodger, vice president-treasurer, said the company was motivated by the tax benefits of leveraged ESOPs, allowing the company to provide slightly increased benefits at a lower cost. The ESOP will replace the company's matching contribution of corporate stock to its 401(k) plan, which now holds about 2% of the shares.

The ESOP will use the \$70.5 million in 10-year loans from Society Bank, Cleveland, to buy some 1.5 million shares of newly issued preferred stock, convertible into 1.1 million common shares, or roughly 8% of the 13.8 million shares outstanding.

Mr. Goodger said Ferro will use the proceeds from the preferred stock sale to buy back an equivalent amount of common shares on the open market to avoid dilution. First Boston Corp., New York, advised the company on the plan and financing, he said.

National City Bank, Cleveland, is trustee for the ESOP and will vote unallocated shares in the same proportion as employees vote their allocated shares, Mr. Goodger noted.

Investments targeted

SACRAMENTO, Calif. — Sixty-four percent of public pension retirement systems with assets in excess of \$5 billion and just more than 50% of all statewide pension systems make economically targeted investments that affect specific targets such as job creation, business development or housing, according to the Institute for Fiduciary Education.

Nearly 100 public retirement systems representing more than \$440 billion in assets responded to an IFE survey on economically targeted investments. The survey was underwritten by the Ford Foundation in New York.

The survey found most economically targeted investments are made in fixed income, real estate, venture capital, small business loans, mortgages and mortgage-backed securities. The targets of the investments

most frequently mentioned were home ownership, job creation, business development and high-technology development. A comprehensive report on the findings will be released in June.

Turnaround fund set

NEWPORT BEACH, Calif. — In a twist on the hot new turnaround funds, distressed company specialists at the Phoenix Group International Ltd. aim to raise \$50 million from institutional investors to invest in — and revitalize — troubled technology-driven companies.

Peter von Braun said he and Charles Missler, the managing general partners of the Phoenix Technology Turnaround Fund L.P., are scouting for companies in the telecommunications, electronics, computer, laser technology and similar industries.

Phoenix joins a host of investment banks and boutiques seeking to identify ailing companies with sound assets that can be infused with new capital and management, strategically repositioned and eventually sold at a significant premium.

More than \$1 billion is being raised from institutional investors for investments in troubled companies (*Pensions & Investment* Age, March 6). Most of the funds are targeting a broad range of companies in various industries.

Mr. von Braun said the fund will take an absolute control position in large-scale turnarounds and initiate mergers, combinations, strategic alliances, joint ventures and development projects and will install new management if necessary.

Each of the managing general partners has at least 20 years' experience in developing and implementing turnaround and corporate development programs. Mr. von Braun spent 11 years with the New York office of McKinsey & Co., the management consulting firm; Mr. Missler was chief executive of Cyphermetics Corp., Precision Instrument Corp. and Western Digital Corp.

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May 10, 1989

PIPER

Basics lead the pack

Top funds follow stock picking fundamentals

By Andrew Reinbach

Takeovers and fundamental stock selection methods helped the top special equity fund for the first quarter in Pensions & Investments' Performance Evaluation Report.

In the first quarter, Equitable Bank, Baltimore, led the pack with a 19.4% return. The bank's \$1.6 million Special Fund had a strong bias toward takeover stocks and those caught in other market plays.

The worst performers were invested in blue-chip stocks and technology issues. Those betting on blue-chip stocks included the \$36 million Personal Trust Fund and the \$14 million Employee Benefit Fund of First Interstate of Arizona, Phoenix. Both funds returned 1.4%. The \$21 million technology fund of Ameritrust Bank, Cleveland, returned 0.2%.

For the quarter, the median PIPER fund returned 7.8%; the Standard & Poor's 500 Stock Index returned 7.1%; and the Russell 2000 returned 7.7%. The PIPER special equity universe is composed of 110 commingled bank and insurance company funds.

For the one- and three-years, one of the best performers was the \$3 million Special Situation Fund managed by Marble Arch Partners, Boston, for Wellington Management Inc. It ranked No. 1 for the year, returning a stunning 54.8%; for the three years, it was No. 2, with a compound annualized 22.7%.

The PIPER median equity fund returned 16% for the year and a compound annualized 8.5% for the three years; for the same periods, the S&P returned 18.1% and 11%, respectively, while the Russell 2000 returned 13% and 4.3%.

W. Patrick Flanagan, Equitable Bank vice president for employee benefit investments, which concentrates mainly in technology, energy and health-care stocks, benefited by market conditions unrelated to company fundamentals.

Three stocks — **Texas Eastern Corp.**, **Interactive Technologies Inc.** and **SmithKline Beckman Corp.** — averaged 45% returns because of takeover efforts. Overall, said Mr. Flanagan, he is weighted 60% in large-capitalization special situation stocks, and 40% in medium-cap special situation stocks. This year, he likes **Cooper Tire & Rubber Co.** and **Fedders Corp.**

"We're playing into the greenhouse effect on Fedders," he said, "and management has substantial stock ownership" because it is a still largely a family owned firm.

The Wellington fund is managed using bottom-up, Graham and Dodd stock-picking techniques.

Marble Arch's managing partner, Bob Beck, described the approach simply as: "Basically, we exploit market inefficiencies. We try to look for well-managed companies that are leaders in their markets and mispriced by the market because of psychological reasons."

He cited **Reuters Holdings PLC**, which has a stodgy market image but practically owns the international stock clearance business, and money-center banks

such as **Bankers Trust New York Corp.** and **Citicorp.**, which the markets perceive as endangered by their large debt exposure to developing nations, as good examples of this.

The leader for the three-year period was the Select Equity Fund of NCNB Texas, Dallas, which returned 46.7%. David L. Gardner, NCNB's senior vice president and director of research, said his fund is basically con-

trarian.

"We tend to buy when stocks are out of favor and they have the lowest p/es per industry group, and hold them," he said. "When the people (on Wall Street) like them and are writing the research reports, we're selling." This year he has bought **McGraw-Hill Inc.**, **Loews Corp.**, **Ramada Inc.**, **Caesars World Inc.** and **Apple Computer Inc.**

On the downside, the three

Special equity funds (periods ended March 31, 1989)

	Quarter	1 yr.	3 yr.	5 yr.	10 yr.
Highest return	19.38%	54.82%	46.72%	35.89%	24.2 %
First quartile	10.13	20.82	12.91	16.92	18.97
Median	7.8	15.99	8.45	13.81	16.58
Third quartile	5.68	9.89	5.03	10.41	14.14
Lowest return	-0.15	-5.25	-2.32	0.29	11.53
S&P 500	7.08	18.11	10.97	17.48	16.36
Russell 2000	7.7	12.97	4.34	11.05	15.97

funds that came in last for the quarter — the technology fund of Cleveland's Ameritrust Bank, and First Interstate of Arizona Bank's Personal Trust and Employee

Benefit funds — also were last for the year. For the 12 months, the Ameritrust fund returned -1.2% and the First Interstate funds,

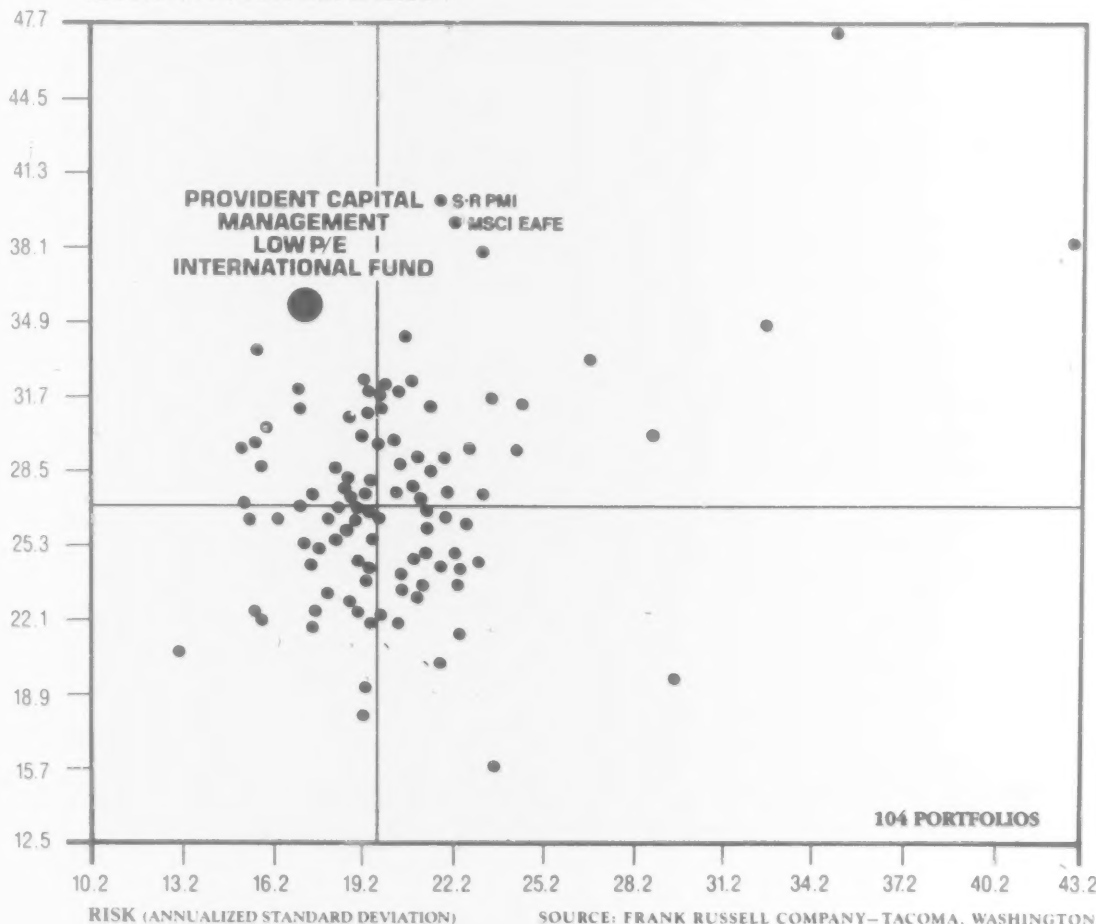
Continued on page 42

Low P/E works overseas, too.

RISK-RETURN COMPARISONS FOR NON-U.S. EQUITY PORTFOLIOS

3 YEARS ENDING DECEMBER 31, 1988

RETURN (ANNUALIZED RATE OF RETURN)



104 PORTFOLIOS

SOURCE: FRANK RUSSELL COMPANY—TACOMA, WASHINGTON

Provident Capital Management, Inc.

The Proof is in the Performance.

1700 Market Street—Suite 2720, Philadelphia, PA 19103-3899

CONTACT: John Campbell, Director of Marketing, (215) 561-6000.

Top quartile commingled special equity funds

	%
Equitable Bank, Md.	19.4
First City Nat'l (G-1), Texas	17.4
Chase Investors (Inter cap.), N.Y.	17.0
Wellington Trust (Spec. sit.)	16.9
Mutual of New York	16.4
Connecticut Bank (Emp. sup.)	16.3
Texas Commerce	16.1
Liberty Nat'l (Growth), Ky.	14.9
Meridian Trust (Quest.), Pa.	13.7
Security Pacific (Growth G), Calif.	13.4
Equitable Capital (Growth), N.Y.	13.2
SLH Trust (Small cap. 5), Del.	12.3
Norwest Bank (Inv.), Minn.	12.1
Provident Capital, Pa.	11.6
Metropolitan Life (SA 43), N.Y.	11.0
Fidelity Mgmt (Agg.), Mass.	10.9
Connecticut Nat'l (Sup.)	10.7
Lincoln Nat'l (Emerg. growth), Ind.	10.6
Merc Bank (Research N), Mo.	10.6
Second Nat'l Bank (Growth), Ohio	10.6
Seafirst Bank (Northwest), Wash.	10.5
SLH Trust (New values 3), Del.	10.5
Wellington Trust (Non-tech)	10.3
Russell 2000	7.7
Standard & Poor's	7.1
1-year returns	
	%
Wellington Trust (Spec. sit.)	54.8
First City Nat'l (G-1), Texas	38.1
Assoc. Bank Neenah (Inc.), Wis.	35.1

Mutual of New York	34.1
Connecticut Nat'l Bank (Sup.)	30.2
Texas Commerce	29.9
Second Nat'l Bank (Growth), Ohio	28.0
Connecticut Bank (Sup.)	27.6
Fidelity Mgmt. (Agg.), Mass.	27.2
Boatmen's Trust (P-1), Mo.	26.4
NCNB Texas (Sel.)	25.6
Fidelity Mgmt. (Small co.), Mass.	25.4
First Wis. Asset (Emerg. C)	24.8
Meridian Trust (Quest.), Pa.	23.8
Mid-State Bank (Beta), Pa.	23.2
Society Nat'l (Central value), Ohio	23.2
Chase Investors (Inter.), N.Y.	22.5
Provident Capital, Pa.	22.1
Wellington Trust (Non-tech)	21.9
Massachusetts Mutual (SIA S)	21.3
Liberty Nat'l (Growth), Ky.	21.1
Trust Co. of the West (Value)	21.0
Chase Investors (Value), N.Y.	20.9
Metropolitan Life (SA 43), N.Y.	20.8
Standard & Poor's	18.1
Russell 2000	13.0

3-year returns

	%
NCNB Texas (Select)	46.7
Wellington Trust (Spec. sit.)	22.7
First City Nat'l (G-1), Texas	21.7
Equitable Capital (Tangible asset)	21.2
SLH Trust (Growth 2), Del.	19.4
SLH Trust (New values 3), Del.	16.7
Assoc. Bank Neenah (Inc.), Wis.	15.9
Society Nat'l (Central value), Ohio	15.6
Connecticut Nat'l (Sup.)	15.1
Nat'l Bank of Detroit (Intrinsic F)	15.0

Society Nat'l (Regional), Ohio	14.6
Assoc. Bank Neenah (Reg.), Wis.	14.4
Mutual of New York	14.4
The Phoenix (Growth S), Conn.	14.1
Massachusetts Mutual (SIA S)	13.9
First Asset Mgmt., Minn.	13.3
Putnam Cos. (Growth), Mass.	13.3
Security Pacific (Growth G), Calif.	13.2
First Asset Mgmt. (20), Minn.	12.9
First Chicago (Inst.)	12.9
SLH Trust (Small cap. 5), Del.	12.9
Standard & Poor's	11.0
Russell 2000	4.3

5-year returns

	%
NCNB Texas (Select)	35.9
SLH Trust (Growth 2), Del.	30.3
SLH Trust (New values 3), Del.	28.3
Fidelity Mgmt. (Agg.), Mass.	22.3
Assoc. Bank Neenah (Inc.), Wis.	22.1
Connecticut Nat'l Bank (Sup.)	20.7
First Asset Mgmt. (20), Minn.	20.4
Chase Investors (Inter.), N.Y.	20.1
First Asset Mgmt., Minn.	19.9
Equitable Capital (Tangible asset)	19.7
Chancellor Capital (Value), N.Y.	19.3
Meridian Trust (Quest.), Pa.	19.1
Security Pacific (Growth G), Calif.	18.2
Society Nat'l (Regional), Ohio	17.6
Standard & Poor's	17.5
Mellon Equity Associates, Pa.	17.4
Metropolitan Life (SA 43), N.Y.	17.1
Nat'l Bank of Detroit (Opp.)	16.9
Russell 2000	11.1

10-year returns

	%
Union Bank (Sup.), Calif.	24.2
MTrust, Texas (Growth), Texas	21.3
Norwest Bank, Minn.	21.0
Chase Investors (Inter.), N.Y.	20.7
Connecticut Bank (Sup.)	20.2
Chancellor Capital (Value), N.Y.	19.9
Provident Capital, Pa.	19.0
Standard & Poor's	16.4
Russell 2000	16.0

Basics

Continued from page 41
-4.3% and -5.3%, respectively. For the three years, the funds moved up slightly, but still ranked in the ninth and 10th percentiles, returning compound annual returns of 0.1%, 1.9% and 1.2%, respectively.

Allan Crowther, the Ameritrust vice president who manages the \$21 million technology fund, said it turned in what he called a typical performance for long-term technology funds, which generally have underperformed the market.

"In general, if you take an index of small-cap technology stocks, you'll see it's been one of the weakest sectors of the market since June 1983," he said.

The market was overly optimistic on technology stocks at the beginning of the decade, Mr. Crowther said, and today they are very cheap.

"I don't know when somebody's going to ring the bell and say 'Wow, these stocks are a good buy,' but it might happen," he said.

"On the other hand, they've looked cheap for some time, and haven't performed well anyway."

The First Interstate of Arizona funds are both large-cap, blue-chip funds.

Richard A. Malcomson, the First Interstate vice president who manages the funds, said he invests in growth stocks with fundamental value and consistency of earnings.

Those stocks include H.J. Heinz Co., American Home Products Corp., Johnson & Johnson, Hewlett-Packard Co., Bristol-Myers Co., General Electric Co. and Emerson Electric Co.

"Growth stocks haven't done well over the past five years, but we're still convinced the cyclical investor has had his day," said Mr. Malcomson.

LTV decision sparks debate

By Jerry Geisel

Crain News Service

NEW YORK — Pension experts are split on whether the federal appeals court decision that forces the PBGC to swallow more than \$2 billion in The LTV Corp. pension liabilities could trigger a wave of terminations of highly underfunded pension plans.

A three-judge panel of the 2nd U.S. Circuit Court of Appeals in New York May 12 unanimously upheld a lower court decision that the PBGC could not return to LTV three previously terminated pension plans with more than \$2 billion in unfunded liabilities.

The PBGC terminated the plans in January 1987 after LTV, which filed for Chapter 11 protection in July 1985, said it no longer could afford to fund the plans.

But in September 1987, the PBGC attempted to force LTV to take back the terminated plans after the company, as part of a collective bargaining agreement with the United Steelworkers union, established a new pension program to provide certain non-PBGC guaranteed benefits.

At the time, the PBGC charged the "follow-on" plans were an illegal continuation of the terminated plans. But the appeals court strongly disagreed, describing the PBGC's decision as "arbitrary and capricious."

The court said it found no evidence in a series of federal benefit laws, including the Employee Retirement Income Security Act of 1974, that Congress ever intended the establishment of new pension programs to be grounds for the restoration of previously terminated pension plans.

While the PBGC argued Section 4047 of ERISA gives it the right to restore terminated plans, "the legislative history of Section 4047 reveals no indication that Congress intended the establishment of successive benefit plans to be a ground for restoration," the appeals court said.

"Congress' focus in enacting Section 4047 was mandating restoration if there was an improvement in financial circumstances," the appeals court said.

At the same time, the appeals court said employers and unions do have the right to bargain for pension benefits after a pension plan is terminated. "Collective bargaining agreements can establish a contractual obligation to provide pension benefits, following termination of a plan, in excess of the amounts guaranteed by PBGC. ERISA contains no restrictions on the employees' rights to receive benefits not guaranteed under ERISA."

While the appeals court acknowledged an improvement in a company's financial condition is grounds for restoration of pension plans, the administrative record did not support the PBGC's finding that LTV's financial circumstances had improved sufficiently to justify restoration.

The problem with the PBGC's restoration decision is that it was based partly on the fact that LTV's operating income during the first five months of 1987 had surpassed earlier projections, the appeals court said.

"But five months is too short of a period of time to determine an income trend," the appeals court said.

The appeals court also said the PBGC failed to "apprise" LTV of the material on which it based its

decision to restore the plans or to give LTV an adequate opportunity to offer contrary evidence.

"Failure to do any of these things renders the decision arbitrary and capricious," the appeals court concluded.

LTV attorneys praised the appellate court ruling. "We have said all along that a company and union have the right and duty to bargain and that plan restoration could not be based on a bargain made in good faith," said Frank Cummings, a partner with LeBoeuf, Lamb, Leiby & MacRae, the Washington counsel for LTV.

PBGC Executive Director Kathleen P. Utgoff said she was surprised and disappointed with the ruling. She added the agency has not decided whether to ask the U.S. Supreme Court to review the decision.

While the decision potentially adds more than \$2 billion to the PBGC's existing \$1.5 billion deficit from other terminated underfunded plans, the PBGC has no plans to ask Congress to raise termination insurance premiums, Ms. Utgoff said.

The previous premium increase, which established a variable-rate premium and went into effect in January 1988, assumed the PBGC would be a hit with a "catastrophic" claim once every five years, she explained.

Pension experts, however, are divided on whether the agency soon could be hit with an explosion of jumbo claims as other companies jettison their pension liabilities onto the PBGC.

Some pension experts had warned in 1987 that an LTV court victory would signal other companies to terminate large underfunded plans, shift the liabilities to the PBGC and then establish cheaper plans that provide benefits not guaranteed by the PBGC.

Some still share that concern.

"The decision increases the likelihood that some corporations could take actions to abuse the PBGC insurance program and in the process abuse the sponsors of defined benefits plans who pay the premiums to support the insurance program," said Dallas Salisbury, president of the Employee Benefit Research Institute, Washington.

But others, citing provisions in 1987 pension reform legislation enacted after the termination of the LTV plans, say a termination boom is not likely to develop.

"The hurdles to be cleared in order for a termination to be allowed are a lot higher," said Frederick Rumack, director of tax and legal services at Buck Consultants Inc. in New York.

The 1987 law, among other things, removed Chapter 11 protection filing as one way in which a company could unload its pension liabilities onto the PBGC.

In addition, the law closed many loopholes that had led to severe underfunding of pension plans and ultimately massive terminations, benefit experts pointed out. And it makes it more difficult for an employer to get a waiver from the Internal Revenue Service from making required pension contributions.

Others say it might be too soon to say whether other big terminations may be in the offing.

"I view the (appellate court) decision as a second round in an ongoing fight," said Gary Ford, former general counsel at the PBGC and now a principal with Groom & Nordberg, Washington.



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